Select Estate & Trusts Provisions

Ways & Means Mark-Up dated 9/13/2021

Present Law

In general

A gift tax is imposed on certain lifetime transfers, and an estate tax is imposed on certain transfers at death. A generation-skipping transfer tax generally is imposed on transfers, either directly or in trust or similar arrangement, to a "skip person" (*i.e.*, a beneficiary in a generation more than one generation younger than that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions.

Income tax rules determine the recipient's tax basis in property acquired from a decedent or by gift. Gifts and bequests generally are excluded from the recipient's gross income.[314]

Unified credit (exemption) and tax rates

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death.[315] The unified credit offsets tax, computed using the applicable estate and gift tax rates, on a specified amount of transfers, referred to as the applicable exclusion amount, or exemption amount. Exemption used during life to offset taxable gifts reduces the amount of exemption that remain s at death to offset the value of a decedent's estate. An election is available under which exemption that is not used by a decedent may be used by the decedent's surviving spouse (exemption portability).

For decedents dying and gifts made before January 1, 2018, the basic exclusion amount that is used to determine the unified credit is $5 million, indexed for inflation for decedents dying and gifts made after 2011. The basic exclusion amount temporarily increases for estates of decedents dying and gifts made after December 31, 2017, and before January 1, 2026. This is

[314] Sec. 102.

[315] Sec. 2010.

accomplished by doubling the basic exclusion amount provided in section 2010(c)(3) of the Code from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011. For 2021, the basic exclusion amount is $11,700,000.[316]

The temporary increase in the basic exclusion amount expires for decedents dying and gifts made after December 31, 2025. At that time, the basic exclusion amount returns to $5 million, indexed for inflation occurring after 2011.

Common tax rate table

A common tax-rate table with a top marginal tax rate of 40 percent is used to compute gift tax and estate tax. The 40-percent rate applies to taxable transfers in excess of $1 million. Because the 2021 exemption amount ($11.7 million) is greater than this $1 million threshold at which the highest marginal tax rate applies, transfers in excess of the exemption amount generally are subject to tax at the 40 percent rate.

Generation-skipping transfer tax exemption and rate

The generation-skipping transfer tax is a separate tax that can apply in addition to either the gift tax or the estate tax. The tax rate and exemption amount for generation-skipping transfer tax purposes, however, are set by reference to the estate tax rules. Generation-skipping transfer tax is imposed at a flat rate equal to the highest estate tax rate (40 percent) in effect at the time of the transfer. Tax is imposed on cumulative generation-skipping transfers in excess of the generation-skipping transfer tax exemption amount in effect for the year of the transfer. The generation-skipping transfer tax exemption for a given year is equal to the estate tax exemption amount in effect for that year ($11.7 million for 2021).

Description of Proposal

The proposal accelerates the expiration of the temporary increase in the estate and gift tax exemption amount. As a result, for decedents dying and gifts made after December 31, 2021, the basic exclusion amount is determined by increasing $5 million for inflation occurring after

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[316] Rev. Proc. 2020-45, 2020-46 I.R.B. 1016, p. 1024 (November 9, 2020). As a conforming amendment to the increase in the basic exclusion amount, Public Law 115-97 also amends section 2001(g) (regarding computation of estate tax). This conforming amendment, which was enacted as a permanent provision, provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out the purposes of section 2001 with respect to differences between the basic exclusion amount in effect at the time of the decedent's death and at the time of any gifts made by the decedent. The purpose of the regulatory authority is to address the computation of the estate tax where (1) a decedent dies in a year in which the basic exclusion amount is lower than the basic exclusion amount that was in effect when the decedent made taxable gifts during his or her life, and (2) such taxable gifts exceeded the basic exclusion amount in effect at the time of the decedent's death. Because the temporary increase in the basic exclusion amount under Public Law 115-97 does not apply for estates of decedents dying after December 31, 2025, it was expected that such guidance would prevent the estate tax computation under section 2001(g) from recapturing, or "clawing back," all or a portion of the benefit of the increased basic exclusion amount used to offset gift tax for certain decedents who make large taxable gifts between January 1, 2018, and December 31, 2025, and die after December 31, 2025. In November 2019, the IRS published final regulations pursuant to this regulatory authority. See Treasury Decision 9884 (November 26, 2019).

2011). The Joint Committee staff currently estimates that the basic exclusion amount under the proposal would be $6,020,000 for 2022.

Effective Date

The proposal is effective for estates of decedents dying and gifts made after December 31, 2021.

8. Increase in limitation on estate tax valuation reduction for certain real property used in farming or other trades of businesses

Present Law

An executor may elect to value for estate tax purposes certain "qualified real property" used in farming or another qualifying trade or business at its current-use value rather than its fair market value.[317] The inflation-adjusted maximum reduction in value for such real property is $1,190,000 for 2021.[318] In general, real property qualifies for special-use valuation only if (1) at least 50 percent of the adjusted value of the decedent's gross estate (including both real and personal property) consists of a farm or closely-held business property and (2) at least 25 percent of the adjusted value of the gross estate consists of farm or closely-held business real property. In addition, the property must be used in a qualified use (for example, farming) by the decedent or a member of the decedent's family for periods aggregating five years or more of during the eight-year period ending on the date of the decedent's death.

If, within 10 years after the decedent's death and before the death of the qualified heir, the heir disposes of an interest in the property or ceases to use the property in its qualified use, an additional estate tax is imposed to recapture the benefit of the special-use valuation.[319]

Description of Proposal

The proposal increases the maximum reduction in value for qualified real property under section 2032A to $11,700,000, indexed for inflation for years after 2021.

Effective Date

The proposal is effective for estates of decedents dying after December 31, 2021.

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[317] Sec. 2032A.

[318] Rev. Proc. 2020-45, I.R.B. 2020-46, p. 1024. Section 2032A(a) provides for a maximum reduction in value of $750,000, with this amount being adjusted for inflation for years after 1997.

[319] Sec. 2032A(c).

9. Certain tax rules applicable to grantor trusts

Present Law

Grantor trusts, in general

A trust is a grantor trust if the grantor or another individual is treated as the owner of all or a portion of the trust for Federal income tax purposes. An individual who is treated as the owner of all or a portion of a grantor trust must include in computing his or her taxable income and credits those items of income, deductions, and credits against tax of the trust that are attributable to the portion of the trust deemed owned by such individual.[320]

In general, a trust with respect to which a grantor has retained a right or benefit described in sections 673 through 679 is treated as a grantor trust. A grantor generally is treated as the owner of a trust for Federal income tax purposes if, for example: she has a reversionary interest in the income or corpus of the trust; she or a non-adverse party has the power to revoke the trust; or she (without the approval or consent of an adverse party) has the power to distribute trust income to herself or to her spouse.[321] As another example, if a U.S. person transfers property to a foreign trust that has a U.S. beneficiary, the grantor trust rules generally treat the transferor as the owner of a portion of the trust for Federal income tax purposes.[322] A grantor's retention of certain administrative powers also may cause a trust to be treated as a grantor trust.[323] For example, a grantor's power to borrow from the corpus or income of the trust without adequate interest or security, or a grantor's power to reacquire the trust corpus and substitute property of equivalent value, may cause the trust to be treated as a grantor trust.[324] In some cases, a person other than the grantor may be treated as deemed owner.[325]

Because a grantor trust and its grantor are treated as one taxpayer for Federal income tax purposes, the IRS has taken the position that transactions between the grantor and the trust generally are disregarded for Federal income tax purposes.[326] In Revenue Ruling 85-13,[327] for example, the IRS concludes that a grantor's acquisition of the corpus of a grantor trust (shares of stock) in exchange for a promissory note is not a sale for Federal income tax purposes, because the grantor is treated as the owner of the shares both before and after the sale. As a result, a

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[320] Sec. 671.

[321] Secs. 673(a), 676(a), and 677(a)(1).

[322] Sec. 679.

[323] Sec. 675.

[324] Secs. 675(2) & (4)(C).

[325] Sec. 678.

[326] *Cf. Rothstein v. United States*, 735 F.2d 704 (2d Cir. 1984).

[327] 1985-1 C.B. 184, 1985.

grantor's acquisition of assets from a grantor trust generally does not result in recognition of gain or loss, and the payment of interest by the trust to the grantor generally does not result in income to the grantor. Similarly, a grantor generally does not realize or recognize gain or loss for Federal income tax purposes on the transfer of appreciated or depreciated assets to the trust.

The IRS also takes the position that the grantor's payment of the income taxes of a grantor trust is not treated as an additional gift to the trust beneficiaries for Federal gift tax purposes, because the grantor is obligated to pay the income tax of the trust.[328]

Federal estate and gift tax treatment of certain transfers in trust

In general, a gift tax is imposed on certain lifetime transfers and an estate tax is imposed on certain transfers at death. For Federal gift tax purposes, a transfer to a trust generally is treated as a gift to the beneficiaries of the trust.[329]

In certain cases, lifetime transfers that are treated as completed transfers for gift tax purposes and thus are subject to gift tax in the year of the transfer nevertheless are included in the transferor's gross estate for Federal estate tax purposes at the time of his or her death.[330] These transfers generally include transfers for less than adequate and full consideration if: (1) the decedent retained the beneficial enjoyment of the property during his or her life;[331] (2) the decedent retained the power to alter, amend, revoke, or terminate a previous lifetime transfer;[332] (3) the decedent held an interest in such property within three years of death;[333] or (4) the transfer takes effect at the death of the decedent.[334]

Intentionally defective grantor trusts ("IDGTs")

As an estate planning technique, taxpayers sometimes structure trusts that are treated as separate from the grantor for Federal transfer tax purposes, but as owned by the grantor for Federal income tax purposes. Such trusts sometimes are referred to as intentionally defective grantor trusts ("IDGTs"), because the taxpayer intentionally includes in the trust agreement a right or power that causes the trust to be treated as a grantor trust under sections 671 through 679.

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[328] Rev. Rul. 2004-64, 2004-2 C.B. 7, 2004.

[329] *Helvering v. Hutchings*, 312 U.S. 393, 396-397 (1941).

[330] See secs. 2035-2038.

[331] Sec. 2036.

[332] Sec. 2038.

[333] Sec. 2035.

[334] Sec. 2037.

Certain rights or powers that result in grantor trust status, however, may not cause the assets of the trust to be included in the grantor's estate for Federal estate tax purposes. In other words, a transfer may, under certain circumstances, be treated as a completed transfer for Federal gift tax purposes, but not for income tax purposes. For example, in certain circumstances a grantor might retain an administrative power that causes the trust to be treated as a grantor trust, such as the power to reacquire the corpus of a trust and to substitute assets of equivalent value under section 675(4)(C), without causing the assets of the trust to be included in the grantor's gross estate under sections 2036 through 2038.

An example of transfer tax planning using IDGTs is an estate "freeze" transaction. In a simple estate freeze transaction, a grantor might transfer assets to such an IDGT by way of a taxable gift during his or her lifetime. The gift tax value is measured ("frozen") at the time of the transfer, and any subsequent appreciation accrues to the trust (and ultimately the trust beneficiaries) without further gift or estate tax consequences, provided the trust is structured to avoid inclusion in the grantor's gross estate. Furthermore, as the deemed owner of the trust assets for income tax purposes, the grantor may satisfy the income tax liability of the trust out of the grantor's separate assets, thereby preserving trust assets for the beneficiaries, without being treated as having made additional taxable gifts to the trust beneficiaries by reason of the tax payments. Finally, any transactions between the grantor and the trust (such as the grantor's reacquisition of the trust corpus) are disregarded for Federal income tax purposes. Because grantors in these estate "freeze" structures often have annuity interests in trust assets, the trusts in these structures are commonly referred to as grantor retained annuity trusts.

Description of Proposal

Application of transfer taxes to certain grantor trusts

The proposal generally is intended to more closely align the income tax and transfer tax (Federal estate and gift tax) rules for grantor trusts by imposing transfer tax consequences on certain assets held in or distributed from a grantor trust. For any portion of a trust with respect to which the grantor is the deemed owner: (1) the gross estate of a deceased deemed owner of such portion includes all assets attributable to that portion at the time of the deemed owner's death; (2) any distribution (other than to a deemed owner or the deemed owner's spouse) from such portion to one or more beneficiaries during the life of the deemed owner of such portion, other than in discharge of an obligation of the deemed owner, is treated as a transfer by gift for gift tax purposes; and (3) if during life the deemed owner ceases to be treated as the deemed owner of such portion, all assets attributable to such portion are treated as having been transferred by gift for gift tax purposes at such time. Proper adjustment must be made for any amounts included in the gross estate or treated as transferred by gift under (1), (2), or (3) to account for amounts treated previously as taxable gifts at the time the deemed owner transferred assets to the trust.

For purposes of the proposal, a "deemed owner" is any person who is treated as owner of a portion of a trust under the grantor trust rules (sections 671 through 679 of the Code). The proposal does not apply to any trust that is includible in the gross estate of the deemed owner (without regard to the proposal).

Certain sales to grantor trusts

In the case of any transfer or property between a trust and a person (whether or not the grantor) who is a deemed owner[335] of the trust (or portion thereof), the proposal provides that the person's treatment as the owner of the trust is disregarded in determining whether there is a sale or exchange for income tax purposes. As a result, such a transfer might result in the realization and recognition of gain.[336] This rule does not apply to any trust that is fully revocable by the deemed owner.

The proposal amends section 267, which disallows certain losses on sales and exchanges between persons with a relationship described in subsection 267(b), to add as one such relationship a grantor trust and the person treated as the owner of the trust (or portion thereof) under the grantor trust rules.

Effective Date

The proposal is effective for (1) trusts created on or after the date of enactment and (2) any portion of a trust established before the date of enactment that is attributable to a contribution made on or after such date.

10. Valuation rules for certain transfers of nonbusiness assets

Present Law

In general

The value of property subject to transfer taxes is the fair market value of the property being transferred on the date of transfer.[337] The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.[338]

If actual sales prices and bona fide bid and ask prices are lacking, the fair market value of stock in a closely held business is determined by looking to various factors including: the company's net worth; its prospective earning power and dividend-paying capacity; the goodwill of the business; the economic outlook overall and in the particular industry; the company's position in the industry and its management; the degree of control of the business represented by

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[335] For purposes of this rule, the term "deemed owner" has the meaning described above.

[336] The proposal thus changes the nonrecognition rule stated in Rev. Rul. 85-13, 1985 C.B. 184, described above.

[337] Secs. 2031 (estate tax), 2512 (gift tax), and 2624 (generation-skipping transfer tax). Fair market value is determined on the date of the gift in the case of the gift tax or on the date of the decedent's death (or on the alternate valuation date if the executor so elects) in the case of the estate tax.

[338] Treas. Reg. secs. 20.2031-1(b) and 25.2512-1.

the block of stock to be valued; and the values of securities of corporations engaged in the same or similar lines of businesses.[339]

Discounts

In general

Courts and the IRS have recognized that for various reasons interests in an entity (shares in a corporation or interests in a partnership, for instance) may be worth less than the owner's proportionate share of the value of the entity's assets. For example, the value of stock held by a 50-percent shareholder might differ from the value of 50 percent of the assets owned by the corporation in which the stock is held. Some (but not all) of the valuation discounts claimed under present law are described below.[340] In many cases courts apply more than one discount. The theories for some discounts overlap, and court decisions sometimes blur the distinctions between those discounts.

Minority (or lack of control) discount

Numerous courts and the IRS have recognized that shares of stock or other ownership interests in a closely-held business entity that represent a minority interest are usually worth less than a proportionate share of the value of the assets of the entity.[341] Minority discounts arise from a division of control because the holder of a minority interest cannot control the ongoing direction of the business entity, the timing and amount of income distributed by the entity to its

[339] Treas. Reg. secs. 20.2031-2(f)(2) and 25.2512-2(f)(2); Rev. Rul. 59-60, 1959-1 C.B. 237, 1959.

[340] Other valuation discounts that courts have recognized include a blockage discount (if the sale of a block of assets, such as 80 percent of the stock of a public company, would depress the market for that asset); a key man (thin management) discount (if the value of a business declines due to the loss of a key manager); and a capital gain (or *General Utilities)* discount (to reflect the tax on gain from the eventual sale of assets acquired by gift or held by a corporation).

[341] See Rev. Rul. 93-12, 1993-2 C.B. 202, 1993; *Propstra v. United States,* 680 F.2d 1248 (9th Cir. 1982); *Ward v. Commissioner,* 87 T.C. 78 (1986); *Estate of Leyman v. Commissioner,* 40 T.C. 100 (1963).

In *Pierre v. Commissioner*, 133 T.C. 2 (2009), the Tax Court allowed minority and marketability discounts in valuing transfers of interests in a single member LLC to trusts established for the transferor's children. The taxpayer had funded the LLC with cash and marketable securities 12 days before she transferred the LLC interests to the trusts. Although the LLC was treated as a disregarded entity for Federal tax purposes under the "check-the-box" regulations, the court rejected the Service's argument that the taxpayer should be treated as having transferred for Federal gift tax purposes a proportionate share of the underlying assets of the LLC and thus should not be entitled to claim valuation discounts. The court reasoned that State law controlled the determination of what property interests were transferred for Federal transfer tax purposes; under State law, the LLC was a separate legal entity, and the taxpayer did not have a property interest in the underlying assets of the LLC. In its opinion, the court noted that "Congress has not acted to eliminate entity-related discounts in the case of LLCs or other entities generally or in the case of a single-member LLC specifically."

owners, or the liquidation of its assets. Minority discounts often result in reductions in the value of transferred property from 15 percent to 40 percent.[342]

Marketability (or illiquidity) discount

Recognizing that closely held stock and partnership interests may be less attractive to investors and may have fewer potential purchasers than publicly traded stock, courts and the IRS grant discounts to reflect the illiquidity of such interests. Courts sometimes combine marketability and minority discounts into a single discount,[343] but the discounts reflect different concerns. Whereas the minority discount compensates for lack of control over an interest, the marketability discount compensates for the limitations upon free exit inherent in interests for which no public market exists. The marketability discount may be appropriate whether valuing a controlling or a minority ownership interest.[344] Generally, the size of the marketability discount is reduced as the donor's or decedent's control of the corporation or partnership increases. However, the discount has been applied to a 100-percent ownership interest in a closely-held corporation.[345] Marketability discounts often result in reductions in the value of transferred property of 20 to 30 percent[346] in addition to any applicable minority discount.[347] Marketability discounts often are created by placing assets in a limited partnership. Marketability discounts claimed through the use of a limited partnership permit the donee or legatee to recreate value by liquidating the partnership or having a partner's interest redeemed by the partnership.

[342] See David T. Lewis and Andrea Chomakos, *The Family Limited Partnership Deskbook: Forming and Funding FLPs and Other Closely Held Business Entities*, ABA Publishing, 2004, p. 11.

[343] *E.g.*, *Central Trust Co. v. United States*, 305 F.2d 393 (Ct. Cl. 1962); *Estate of Titus v. Commissioner*, T.C. Memo 1989-466.

[344] Controlling shares in a nonpublic corporation, which do not qualify for a minority discount, may nonetheless receive a marketability discount because there is no ready private placement market and because transaction costs would be incurred if the corporation were to publicly offer its stock.

[345] See, *e.g.*, *Estate of Bennett v. Commissioner*, T.C. Memo 1993-34, in which the Tax Court concluded that in determining the discount, the corporate form could not be ignored. ("Here, we have a real estate management company whose assets are varied and nonliquid. We think that the corporate form is a quite important consideration here: there is definitely a difference in owning the assets and liabilities of Fairlawn directly and in owning the stock of Fairlawn, albeit 100 percent of the stock. We think some discounting is necessary to find a buyer willing to buy Fairlawn's package of desirable and less desirable properties.").

[346] There is no established formula to compute the size of a discount. One measure of the size of a discount, applicable when valuing a controlling interest, is the total cost of registering securities with the Securities and Exchange Commission, *i.e.*, converting nonliquid securities into liquid ones. Other factors considered are the size of any costs and the amounts realizable on a private placement or secondary offering, the opportunity cost of losing access to the invested funds, and the discounts applied in comparable transactions involving sales of comparable closely held businesses.

[347] The Tax Court has noted that the application of a minority discount and a marketability discount is multiplicative rather than additive. According to the Court, the minority discount should be applied first and then the marketability discount should be applied to that figure. For example, a 20-percent minority discount and a 40-percent marketability discount should result in a 52-percent discount (20 percent + (40 percent x 80 percent)), not a 60-percent discount. See *Estate of Bailey v. Commissioner*, T.C. Memo 2002-152.

Fragmentation (or fractional interest) discount

Fragmentation discounts are similar to minority discounts. This discount arises from the lack of control inherent in joint ownership of an asset (*e.g.*, a gift of an undivided fractional interest in real estate).[348] Fragmentation discounts often result in reductions in the value of transferred property of 15 to 60 percent.[349]

Investment company discount

The investment company discount arises because the market values of closed-end mutual funds and investment companies often are less than the net asset values of those funds and companies. These discounts may overlap with the marketability discount.[350]

Description of Proposal

For estate and gift tax purposes, the proposal disallows the use of valuation discounts in valuing certain transfers of nonbusiness assets. In the case of the transfer of any interest in an entity other than an interest which is actively traded,[351] the value of any nonbusiness assets held by the entity with respect to such interest are determined as if the transferor had transferred such assets directly to the transferee, and no valuation discount is allowed with respect to such nonbusiness assets. The value of such nonbusiness assets is disregarded when determining the value of the interest in the entity.

The term "nonbusiness asset" means any passive asset held for the production or collection of income that is not used in the active conduct of a trade or business. For this purpose, a passive asset is not treated as used in the active conduct of a trade or business unless the asset is: (a) generally, inventory property or accounts or notes receivable,[352] or a hedge with respect to such property; or (b) real property used in the active conduct of one or more real

[348] Because the holder of a fractional interest in real property has the power to compel partition (a remedy not available to minority holders of other interests), the discount should reflect the cost of partition and the value of the interest secured thereby. See Boris I. Bittker & Lawrence Lokken, *Federal Income Taxation of Estates, Gifts, and Trusts*, 2d ed., 1993, para. 135.3.4. Courts, however, often apply a minority discount instead. See, *e.g.*, *LeFrak v. Commissioner*, T.C. Memo 1993-526.

[349] See, *e.g.*, *Estate of Van Loben Sels v. Commissioner*, T.C. Memo 1986-501.

[350] For example, the Tax Court in *Estate of Folks v. Commissioner*, T.C. Memo 1982-43, granted the taxpayer a 50-percent investment company discount and then applied to the resulting value a 50-percent marketability discount, resulting in a total discount of 75 percent.

[351] The term "actively traded" is defined by reference to section 1092. The regulations under section 1092 generally define the term to mean property for which there is an established financial market. See Treas. Reg. sec. 1.1092(d)-1(a).

[352] More specifically, the provision references property described in section 1221(a)(1) ("stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business") and 1221(a)(4) ("accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1)").

property trades or businesses[353] in which the transferor materially participates and with respect to which the transferor meets an hours-based requirement.[354] Material participation is determined under the rules of section 469(h),[355] which generally require that the taxpayer be involved in the operations of the activity on a basis that is regular, continuous, and substantial. Notwithstanding the general rule stated above, a passive asset that is held as part of the reasonably required working capital needs of a trade or business is treated as used in the active conduct of a trade or business.

The term "passive asset" means any:

- Cash or cash equivalents;
- Except to the extent provided by the Secretary, stock in a corporation or any other equity, profits, or capital interest in a partnership;
- Evidence of indebtedness, option, forward or futures contract, notional principal contract, or derivative;
- Foreign currency;[356] interest in a real estate investment trust, common trust fund, regulated investment company, or publicly traded partnership;[357] or interest in a precious metal;[358]
- Annuity;
- Real property;
- Asset (other than a patent, trademark, or copyright) which produces royalty income;
- Commodity;

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[353] The term "real property trade or business" has the meaning given the term under section 469(c)(7)(C) ("any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business").

[354] See sec. 469(c)(7)(B)(ii) (requiring that the taxpayer perform more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates).

[355] For this purpose, the material participation standards of section 469(h) area apply without regard to the limitation to farming activity in section 469(h)(3).

[356] Sec. 351(e)(1)(B)(iii).

[357] As described in section 351(e)(1)(B)(iv), including any other equity interest (other than in a corporation) which pursuant to its terms or any other arrangement is readily convertible into, or exchangeable for, any asset described in this clause (*i.e.*, an interest in a real estate investment trust, common trust fund, regulated investment company, or publicly traded partnership), an interest in a precious metal, or any other asset prescribed by the Secretary in regulations.

[358] As described in section 351(e)(1)(B)(v).

- Collectible;[359]
- Personal property[360] or position in personal property;[361] or
- Other asset specified in regulations prescribed by the Secretary.

The proposal includes a look-through rule that applies if a passive asset of an entity consists of a 10-percent interest in another entity. In such cases, the valuation rules of the proposal are applied by disregarding the 10-percent interest and by treating the entity as holding directly its ratable share of the assets of the other entity. This rule is applied successively to any 10-percent interest of such other entity in any other entity. The term "10-percent interest" means: (a) ownership of at least 10 percent (by vote or value) of the stock of a corporation; (b) ownership of at least 10 percent of the capital or profits interest in a partnership; and (c) ownership of at least 10 percent of the beneficial interests in any other entity. For purposes of the definition of a 10-percent interest, the ownership attribution rules of section 318 apply.[362] Thus, for example, if a transferor is transferring an interest in Entity 1, which has an 8 percent interest in Entity 2, and transferor separately has a direct 5 percent interest in Entity 2, the look-through rule applies.

The proposal directs the Secretary to issue such regulations or other guidance as is necessary or appropriate to carry out the proposal, including regulations or other guidance to: (1) determine whether a passive asset is used in the active conduct of a trade or business; and (2) determine whether a passive asset is held as part of the reasonably required working capital needs of a trade or business.[363]

Effective Date

The proposal is effective for transfers after the date of enactment.

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[359] Within the meaning of section 408(m) (*i.e.*, any work of art, rug or antique, metal or gem, stamp or coin, alcoholic beverage, or other tangible personal property specified in regulations).

[360] As defined in section 1092(d)(1) ("property of a type which is actively traded").

[361] Within the meaning of section 1092(d)(2) ("an interest (including a futures or forward contract or option) in personal property").

[362] Section 318 includes rules for constructive ownership of stock that generally apply for determining whether a redemption of stock is treated as a sale or exchange. These rules, in some cases, treat the shareholder as owning stock that is in fact owned by another person, such as a family member or an entity or trust. For example, an individual generally is treated as owning stock owned directly or indirectly by his or her spouse, children, grandchildren, or parents. Sec. 318(a)(1). Certain stock owned directly or indirectly by a partnership, estate, trust, or corporation is treated as owned by the partners, beneficiaries (or a deemed owner in the case of a grantor trust), or shareholders. Sec. 318(a)(2). A partnership, estate, trust, or corporation is treated as owning certain stock owned directly or indirectly by partners, beneficiaries (or a deemed owner in the case of a grantor trust), or shareholders. Sec. 318(a)(3). A person who has an option to acquire stock is treated as owning the stock. Sec. 318(a)(4).

[363] Subsection 2031(b) (relating to the valuation of unlisted stock and securities for purposes of determining the value of a decedent's gross estate) is to be applied after the valuation rules of the proposal.